GRAND UNION
SUPERMARKETS

Grand Union Annual Report 1978

Contents

Financial Highlights 1978

	52 weeks ended	
	March 31, 1979	April 1, 1978 (Restated)
Sales	**$ 2,398,944,000**	$ 1,649,274,000
Income before income taxes	**35,004,000**	22,003,000
Net income	**21,863,000**	14,619,000
Net income as a percent of sales	**.91%**	.89%
Working capital	**120,157,000**	151,517,000
Ratio of current assets to current liabilities	**1.47 to 1**	2.09 to 1
Number of retail outlets at fiscal year end	**862**	502

Amanda Pressley exudes a cheerful attitude as a Courtesy Clerk at a Big Star Supermarket in Atlanta, Georgia.

The Chairman's Letter

Last year marked what was undoubtedly the singular most important event in the 107-year history of The Grand Union Company: the acquisition of Colonial Stores Incorporated of Atlanta, Georgia, adding 359 supermarkets and approximately $1.1 billion in annual sales to Grand Union's $1.7 billion in sales.

Grand Union operations span the entire Eastern seaboard, ranging from the Canadian border in upstate New York and Vermont, south to the Florida Keys and the Gulf of Mexico, plus Puerto Rico and the U.S. Virgin Islands.

Grand Union acquired Colonial Stores through a cash tender offer that was completed in late August, 1978. On February 3 of this year, Colonial was merged into Grand Union.

Included in Grand Union's 1978/79 financial results for the 52-weeks ended March 31, 1979, are 31 weeks of Colonial operations. On this basis, the Company reported sales of $2,398,944,000 for the year as compared with sales of $1,649,274,000 for Grand Union only during the prior year. Net earnings for the latest fiscal year of $21,863,000 show a substantial increase over the prior year's net of $14,619,000. The Company's earnings rate of 0.9% on sales compares most favorably with the more profitable food chains in the United States.

The Company's profit performance was especially significant in view of vigorous competition throughout all of its trading areas and continued inflationary pressures on the consumer's food budget which resulted in sporadic periods of buying resistance. This pressure has been most pronounced in the meat category with the severe escalation in the cost of beef.

Grand Union was in a good position to meet this challenge. In recent years, it has greatly improved its store development program and merchandising concepts while at the same time devising and maintaining strong financial systems and efficient expense control. These factors have given the organization a continuing, improved ability to meet any new challenges from competition.

The task currently facing the combined Grand Union/Colonial operations is to optimize the benefits from the coordination of administrative functions and the integration of merchandising and operating policies in order to establish a better foundation for the Company's continued growth in its new, enlarged form.

The work of integration is well advanced and it is expected to yield the improved levels of operational efficiency initially planned. It is expected that a much stronger single entity will emerge from this integration, better suited to meet the new challenges of the 1980's.

As a first step, the Grand Union form of regional control has been introduced into Colonial operations. Colonial's five divisions have been restructured and clustered, along with one Grand Union division, into three geographic regions. The senior management selected to head up these regions has been drawn from both companies and represents the strongest operational talents in each.

The Washington and Norfolk Divisions have been grouped into an Eastern Region, headed by Kenneth A. Brown, Regional Vice President. The Columbia and Raleigh Divisions now comprise the Carolina Region headed by Henry S. Addison, Regional Vice President, while the Atlanta and Thomasville Divisions now comprise the Southern Region headed by Peter M. Whelan, Regional Vice President.

I am pleased to announce that in May of this year, Patrick A. Deo was elected President and Chief Operating Officer of the Company. Mr. Deo had formerly served as Executive Vice President and Chief Operating Officer. Alan C. Goulding, Executive Vice President, has also been given responsibility as President of the Colonial Stores Division of the Company. In recognition of their contribution to the growth of Grand Union, Messrs. Deo and Goulding, as well as Stuart S. Tarrant, Executive Vice President in charge of Finance and Administration, have been elected to the Company's Board of Directors.

On behalf of the Board of Directors, I would like to thank Representative William S. Green for his many years of dedicated service as a Director of Grand Union. Mr. Green resigned from the Board recently because of his new responsibilities in the U.S. Congress. We all wish him well in his new political career.

A number of former Colonial executives have been elected to positions within Grand Union. James W. Rowe has been named Senior Vice President and both William F. Stewart and William G. Spearman have been elected Corporate Vice Presidents.

Louis Sherwood has been elected Senior Vice President in charge of Development, while Joseph J. McCaig has been named a Corporate Vice President with continuing responsibility for the chain's Northern Region.

I should like to extend special thanks to Thomas R. Doyle, Executive Vice President and Assistant to the Chairman, who is retiring from Grand Union on August 1 after a 50-year career with our Company. Mr. Doyle has been one of the key men responsible for the growth of our organization and his presence will be missed in our day-to-day management. Mr. Doyle will continue to serve on the Board of Directors.

A program of developing new and innovative stores throughout the operating area continues with plans for 47 new units this year, most of them in the larger 28,000-square-foot class. We are planning 19

enlargements and 40 renovations. This compares with 45 new store openings, nine enlargements and 24 renovations for the combined companies last year.

In January, Grand Union opened its new supermarket prototype in Wyckoff, New Jersey, a suburb of New York City. The decor of the 28,000-square-foot unit was planned by the internationally famous designer Milton Glaser and, together with the advanced technology developed by the Grand Union architectural team, this supermarket is the most advanced concept in supermarket design in the United States today.

As Grand Union advances into its 108th year this Fall, the Company is well-poised to meet the competitive and economic challenges that lie ahead. We should be able to demonstrate strength in the marketplace and produce satisfactory results.

I should like to take this opportunity on behalf of management to thank the 33,000 members of the Grand Union team for their excellent efforts on behalf of the Company.

Sincerely,

James Wood

July 5, 1979

James Wood
Chairman of the Board and
Chief Executive Officer

Patrick A. Deo
President and
Chief Operating Officer

Thomas R. Doyle
Executive Vice President and
Assistant to the Chairman

Alan C. Goulding
Executive Vice President
and President of
Colonial Stores Division

Stuart S Tarrant
Executive Vice President-
Finance and Administration

Grand Union Today

The Grand Union Company was founded in 1872 as a one-man, one-store operation in Scranton, Pennsylvania. From that humble beginning, it has today evolved into one of the nation's most respected supermarket chains.

Last year, Grand Union acquired Colonial Stores Incorporated of Atlanta, Georgia, thus adding 359 stores in seven Southeastern states. Today, the Company operates a total of 840 supermarkets in 15 Eastern seaboard states, Puerto Rico and the U.S. Virgin Islands.

Colonial, itself, had a history dating back to 1901 with the incorporation of the David Pender Grocery Company in Norfolk, Virginia. The Pender Company became Colonial Stores in 1940 when it was merged with the Southern Grocery Company.

The modern Grand Union organization operates a multitude of diverse and interesting food stores, ranging in size up to 38,865-square-feet. The chain maintains a fleet of more than 800 trucks distributing food and general merchandise items from 15 warehouses. It employs more than 33,000 employees, both full and part time, in a variety of store, distribution and office functions.

Grand Union today has 15 operating divisions grouped into five geographic regions for maximum control of operations. Three divisions, the Florida East, Florida West and Caribbean Divisions, operate autonomously.

Operating mainly under the trade names of Grand Union and Big Star, the Company has retail outlets in numerous major markets, including Albany, New York; New York City; Washington, D.C.; Baltimore, Maryland; Richmond, Virginia; Norfolk, Virginia; Winston-Salem, North Carolina; Columbia, South Carolina; Atlanta, Georgia; Jacksonville, Florida, and Miami, Florida.

As a general rule, the Company leases the bulk of its facilities, preferring to utilize its capital for the development of new and innovative supermarkets in its trading area.

Strong financial control exists throughout Grand Union and the Company has achieved an excellent reputation within the supermarket and investment community for the sophistication and depth of the financial data available.

As an impetus to increase sales volume, the chain relies heavily on newspaper, direct

The Big Star supermarket in Dunwoody, Georgia, creates an atmosphere of shopping in a number of small, specialty shops.

Cashier Lisa Herndon examines hard-to-find delicacies from all over the world at the Dunwoody store's International Department.

mail and electronic media advertising, as well as a diverse array of sales promotion methods. These include continuity promotions and games.

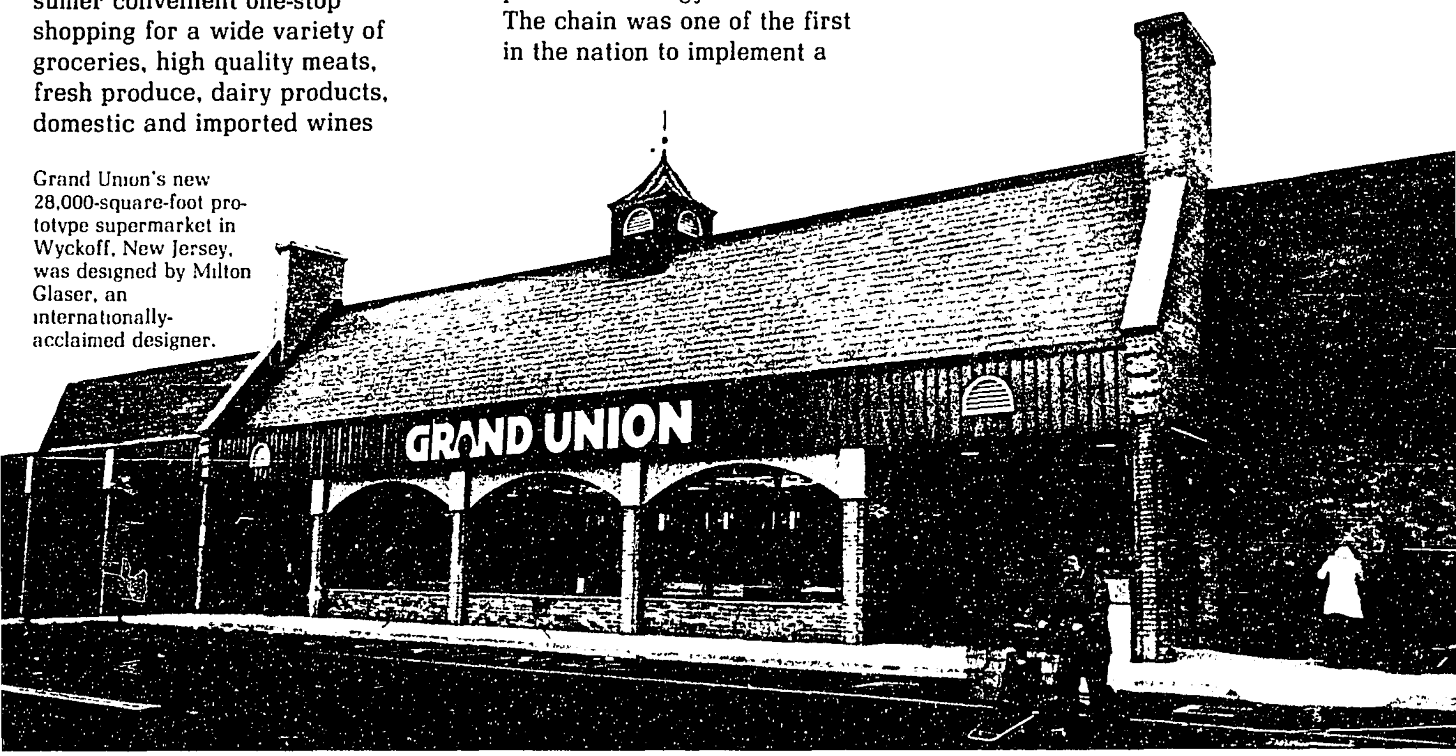
Only recently, the Company embarked upon new merchandising programs in its Northern and Southern Regions, emphasizing hundreds of price reductions on food and general merchandise items.

The chain's stores are designed to provide the consumer convenient one-stop shopping for a wide variety of groceries, high quality meats, fresh produce, dairy products, domestic and imported wines where allowed by law, health and beauty aids, party goods, books and magazines, and many other items modern shoppers have indicated they wish to buy in the supermarket where they make their major weekly food purchases. Many stores contain bakeries and service delicatessen departments as a further extension of the one-stop shopping concept.

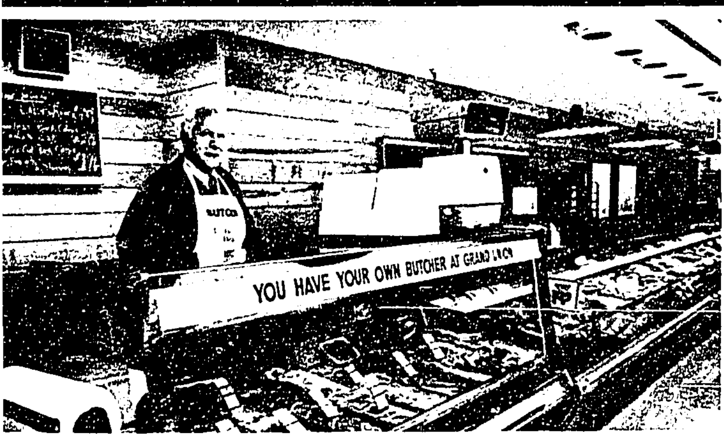
ENERGY CONSERVATION

Grand Union has long been a pioneer in energy conservation. The chain was one of the first in the nation to implement a voluntary chainwide energy conservation program more than five years ago. It uses heat reclamation systems in many stores to recapture warm air emitted from refrigeration equipment and recycles it back into the store to provide warmth in the winter.

The Company has also been experimenting with a number of devices to control the use of energy in stores, offices and distribution centers through the aid of mini-computers.



Grand Union's new 28,000-square-foot prototype supermarket in Wyckoff, New Jersey, was designed by Milton Glaser, an internationally-acclaimed designer.



Service Butcher Cliff Ackerman will custom cut meat purchases to customer specifications at the Wyckoff store's Prime Meat and Gourmet Service Counter

Bakery Manager Jerry Ramback and his two assistants, Alice Bullwinkel and Bridget Rabideau, prepare to deliver some of the donuts they baked for a local charity fund raising campaign in Plattsburgh, New York

Maintenance crews constantly monitor the performance of all devices which use energy to make sure they are properly tuned for the utmost in energy efficiency.

QUALITY CONTROL

The majority of the Company's more than 1,500 private label goods are manufactured by others to our rigid specifications. The chain maintains its own Quality Control Laboratory in its Elmwood Park, New Jersey, offices, and uses a number of outside, independent laboratories to assure the maximum quality control for all products bearing any of its trade names.

Grand Union has long prided itself as a merchant of good food at reasonable prices. Its private label items, especially, provide the highest quality food available at prices below those of nationally-branded manufacturers. They are an extremely important item in today's economy where conscientious shoppers are trying to tailor their food purchasing patterns to keep up with spiraling food inflation.

The Company prides itself on being a good "Corporate Citizen" at all times. Government rules and regulations are carefully followed. Employees are encouraged to take active roles in community affairs, and each Grand Union facility tries to make an important contribution to the good health and welfare of every community in which it operates.

GRAND WAY DIVISION

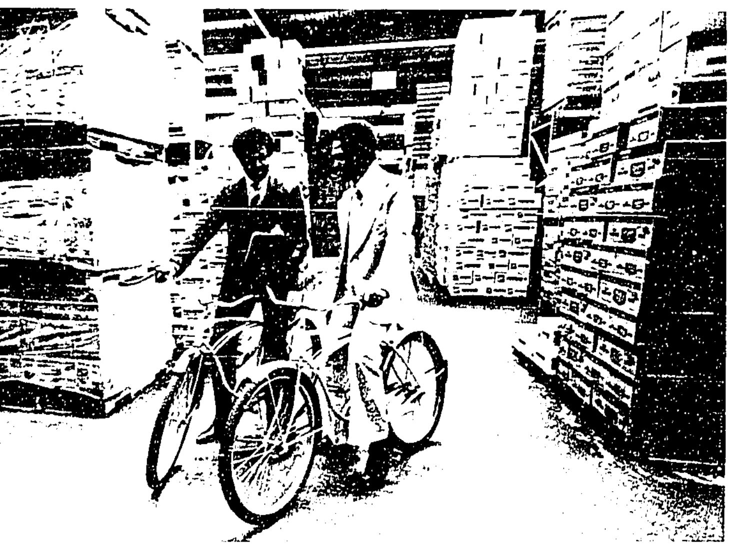
In June,1979, the Company began a series of "going out of business" clearance sales at its 14 Grand Way general merchandise discount stores. The leases on seven stores in New York, New Jersey and Pennsylvania will be assumed by the K-mart Corporation of Troy, Michigan. Leases on five additional units in Florida, New York and Pennsylvania are being assumed by the Zayre Corporation of Framingham, Massachusetts. Negotiations are continuing for the disposition of the remaining units.

The Company's seven Grand Catalog Showrooms, merged into the Grand Way Division two years ago, will continue as an on-going business.

ON THE INTERNATIONAL SCENE

Grand Union is a wholly-owned subsidiary of Generale Occidentale, S.A., a large French food manufacturing and retailing organization with operations throughout the United Kingdom and western Europe.

Thus as Grand Union moves forward, it is a respected part of the world community as an integral member of a large, multi-national organization with a prestigious worldwide reputation.



At the Atlanta, Georgia, Distribution Center, Grocery Warehouse Superintendent Herman Ponder (left) and Grocery Warehouse Foreman Burnes Johnson, Jr., use bicycles to make their rounds.

In Quitman, Georgia, General Manager Stan Shiver (center) is known as "Mr. Big Star." With him are Cashier Francis Weeks and Produce Manager Dave White.

Consolidated Statement of Income and Retained Earnings

The Grand Union Company and Subsidiaries
(Amounts in thousands)

	52 weeks ended March 31, 1979	52 weeks ended April 1, 1978 (Restated)
Sales	$ 2,398,944	$ 1,649,274
Cost of sales	1,861,470	1,283,853
Gross profit	537,474	365,421
Operating, administrative and general expenses (notes 8 and 9)	(494,146)	(340,410)
Interest expense	(13,139)	(8,369)
Interest income, principally on temporary cash investments	4,815	5,361
Income before income taxes	35,004	22,003
Income taxes (notes 2 and 4)	(13,000)	(7,384)
Income before minority interest	22,004	14,619
Minority interest in earnings of subsidiary (note 1)	(141)	—
Net income	21,863	14,619
Retained earnings, beginning of year:		
As previously reported	82,995	70,596
Retroactive restatement of prior years' earnings (note 8)	(2,798)	(2,675)
As restated	80,197	67,921
	102,060	82,540
Less cash dividends:		
Common	(6,400)	(2,265)
Preferred	(70)	(78)
Retained earnings, end of year	$ 95,590	$ 80,197

See accompanying notes to financial statements.

Consolidated Balance Sheet

The Grand Union Company and Subsidiaries
(Amounts in thousands)

	March 31, 1979	April 1, 1978 (Restated)
ASSETS		
Current assets:		
Cash (note 7)	$ 25,951	$ 155
Temporary cash investments, at cost (approximates market value)	20,838	99,655
Accounts receivable	11,114	7,255
Inventories (note 2)	249,231	171,752
Prepaid taxes, operating supplies and other	12,155	9,956
Properties to be sold within one year (note 2)	55,176	2,083
Total current assets	374,465	290,856
Property, net (notes 2 and 3)	216,761	127,195
Other assets and deferred charges	23,584	1,329
Investments, at cost	13,916	8,765
Cost in excess of net assets of businesses acquired (notes 1 and 2)	13,176	7,412
	$ 641,902	$ 435,557
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Short-term debt (note 6)	$ 30,693	$ —
Accounts payable and accrued liabilities	213,531	135,259
Federal income taxes (notes 2 and 4)	10,084	4,080
Total current liabilities	254,308	139,339
Long-term debt (note 6)	88,980	65,000
Long-term capital lease obligations (note 8)	66,652	36,585
Deferred pension obligations (note 9)	21,750	—
Deferred federal income taxes (note 4)	11,025	11,622
Other non-current liabilities	1,005	130
	443,720	252,676
Stockholders' equity:		
4½% cumulative preferred stock, $50 par value, callable at $52 per share; authorized 116,000 shares, outstanding 31,412 and 34,567 shares respectively (note 5)	1,571	1,728
Common stock, $50,000 and $5 par value respectively, authorized 900 and 9,000,000 shares respectively, issued 626.5 and 6,265,346 shares respectively	31,327	31,327
Additional paid-in capital (note 5)	69,694	69,629
Retained earnings (note 6)	95,590	80,197
Total stockholders' equity	198,182	182,881
	$ 641,902	$ 435,557

See accompanying notes to financial statements.

The Grand Union Company and Subsidiaries
(Amounts in thousands)

Consolidated Statement of Changes in Financial Position

	52 weeks ended March 31, 1979	52 weeks ended April 1, 1978 (Restated)
FUNDS PROVIDED:		
Net income	$ 21,863	$ 14,619
Charges to net income not affecting working capital:		
Depreciation and amortization:		
Property owned	22,921	18,071
Property leased	3,694	1,813
Other	652	—
Deferred federal income taxes	(597)	570
Working capital provided from operations	48,533	35,073
Increase in long-term debt	10,000	15,000
Increase in long-term capital lease obligations	9,837	10,110
Book value of property dispositions	6,348	8,715
	74,718	68,898
FUNDS USED:		
Acquisition of Colonial Stores Incorporated (less working capital):		
Property, plant and equipment	77,732	—
Other non-current assets	29,568	—
Non-current liabilities	(62,483)	—
Property additions:		
Property owned	41,529	21,838
Property leased	3,268	5,531
Dividends paid	6,470	2,343
Reduction in long-term capital lease obligations	4,719	2,043
Increase in investments	5,151	8,765
Others, net	124	(61)
	106,078	40,459
Increase (decrease) in working capital	$ (31,360)	$ 28,439
CHANGES IN WORKING CAPITAL:		
Increase (decrease) in current assets:		
Cash	$ 25,796	$ (4,117)
Temporary cash investments	(78,817)	36,705
Accounts receivable	3,859	908
Inventories	77,479	14,167
Prepaid taxes, operating supplies and other	2,199	(436)
Properties to be sold within one year	53,093	(673)
	83,609	46,554
Increase (decrease) in current liabilities:		
Short-term debt	30,693	—
Accounts payable and accrued liabilities	78,272	19,140
Federal income taxes	6,004	(1,025)
	114,969	18,115
Increase (decrease) in working capital	$ (31,360)	$ 28,439

See accompanying notes to financial statements.

Notes to Financial Statements

NOTE 1 - ORGANIZATION:

On July 29, 1977 pursuant to a merger agreement, Cavenham (USA) Inc., a wholly-owned subsidiary of Cavenham Holdings Inc., acquired the remaining 19% minority interest outstanding in the Company's common stock, at which time, the Company became a wholly-owned subsidiary. In connection with the merger and a prior exchange offer, certain restrictions were imposed on the Company, including among others, limitations on its ability to incur additional debt and to issue additional stock.

On August 29, 1978 and November 20, 1978 the Company acquired 91% and 9%, respectively, of the outstanding shares of Colonial Stores Incorporated ("Colonial"), a retail food chain, for cash approximating $139,000,000. In connection with the acquisition and the subsequent merger of Colonial into the Company on February 3, 1979, Colonial's stock option plans were terminated, its outstanding 4% cumulative preferred stock was redeemed and the Company assumed all obligations with respect to the outstanding $15,000,000 principal amount of Colonial's 8% Sinking Fund Debentures due 1996.

The acquisition of the Colonial shares has been accounted for as a purchase and accordingly the difference between the fair value of net tangible assets acquired and the purchase price has been recorded as an intangible amount of $5,836,000.

The accompanying financial statements include the results of operations of Colonial based on the varying levels of ownership from the respective dates of acquisition.

The following unaudited pro forma summary represents the consolidated results of operations of the Company as though Colonial had been acquired at the beginning of each year presented:

	52 weeks ended	
	March 31, 1979	April 1, 1978
	(in thousands)	
Sales	$2,876,000	$2,718,000
Net income	$ 25,300	$ 23,600

NOTE 2 - SUMMARY OF ACCOUNTING POLICIES:

The significant accounting principles affecting the Company's financial statements are summarized below.

Fiscal Year: The Company's fiscal year ends on the Saturday nearest the last day of March.

Principles of Consolidation: The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany transactions and balances have been eliminated.

Inventory Valuations: Inventories are valued at the lower of cost (first-in, first-out) or market value, cost being determined using the retail method for store inventories and average cost for warehouse and other inventories.

Property Leased: Effective with the first quarter of 1978 the Company changed its method of accounting for leases entered into prior to 1977 to comply with the provisions of Financial Accounting Standards Board Statement 13 (FAS 13) and accordingly financial statements of prior years have been restated to apply such provisions retroactively (see Note 8). Prior to this change, only leases entered into subsequent to December 31, 1976 were accounted for under the provisions of FAS 13.

Property: The costs of significant additions, renewals and improvements of leased and owned properties are capitalized. Properties held under capital leases are capitalized net of any gains on sale and leaseback transactions and are amortized using the straight-line method over the life of the lease. Depreciation on owned property is computed, principally on the straight-line method, to amortize the cost of depreciable properties over their useful lives. Leasehold improvements are amortized over the shorter of the terms of the lease or their estimated useful lives. Maintenance and repairs which do not improve or extend the life of the respective assets are charged to expense when incurred.

Certain facilities held for sale or sale and leaseback have been classified as properties to be sold within one year.

Pre-Opening Costs: Store pre-opening costs are charged to expense as incurred.

Cost in Excess of Net Assets of Businesses Acquired: Amounts arising from the acquisition of Colonial are being amortized on a straight-line basis over forty years (see Note 1).

Management does not believe that the remaining amounts, which arose from acquisitions made prior to November 1, 1970, have diminished in value and accordingly is not amortizing such amounts.

Income Taxes: The Company is a party with Cavenham (USA) Inc. and Cavenham Holdings Inc. to a tax sharing agreement whereby the consolidated operations of the Company will be included in consolidated tax returns filed by Cavenham Holdings. Under the agreement, the Company receives tax sharing payments equal to 15% of the amount, if any, by which the Company's consolidated federal income tax exceeds the consolidated tax liability of Holdings. Such sharing payments are applied as a reduction of the Company's consolidated federal income tax provision.

Investment tax credits are accounted for as a reduction of income taxes in the year that the credits arise.

Pension Plans: The Company maintains noncontributory, trusteed pension plans covering substantially all eligible employees and a supplemental non-qualified, non-trusteed plan for certain executives. The Company's policy is to fund pension costs accrued. Pension expense for the noncontributory plans consists of normal costs plus amortization of past service costs over a forty year period.

NOTE 3 - PROPERTY:

Property, at cost, consists of the following:

	March 31, 1979	April 1, 1978
	(in thousands)	
Property owned:		
Land	$ 6,145	$ 4,869
Buildings	6,200	4,381
Fixtures and equipment	225,913	177,012
Leasehold improvements	54,366	40,893
	292,624	227,155
Less - accumulated depreciation and amortization	139,719	127,598
Property owned	152,905	99,557
Property leased:		
Land and buildings	73,154	41,281
Equipment	4,898	4,040
	78,052	45,321
Less - accumulated amortization	14,196	17,683
Property leased	63,856	27,638
Property, net	$ 216,761	$ 127,195

NOTE 4 - INCOME TAXES:

The components of income tax expense are as follows:

	52 weeks ended	
	March 31, 1979	April 1, 1978
	(in thousands)	
Federal income tax:		
Currently payable net of tax sharing credit	$ 10,891	$ 6,873
Deferred, consisting of:		
Excess of tax over book depreciation	1,283	1,200
Gains on sale-leaseback	(1,507)	(1,403)
Other	50	(743)
State income tax	2,283	1,457
Total income tax provision	$ 13,000	$ 7,384

The reconciliation of the provision for income taxes computed at the federal statutory rate to the reported provision for income taxes is as follows:

	52 weeks ended	
	March 31, 1979	April 1, 1978
	(in thousands)	
Provision computed at federal statutory tax rate	$ 16,627	$ 10,561
Increase (decrease) in the provision resulting from:		
Tax sharing benefits	(796)	(698)
Current year's investment tax credit	(2,711)	(1,600)
Utilization of capital loss carryforwards	—	(949)
State and local taxes, net of federal tax benefit	1,199	758
Others, net	(1,319)	(688)
Total income tax provision	$ 13,000	$ 7,384

NOTE 5 - STOCKHOLDERS' EQUITY:

Changes in additional paid-in capital and treasury stock are as follows:

	Paid-in Capital	Treasury Stock
	(in thousands)	
Balance April 2, 1977 (includes 346,957 common shares and 435 preferred shares held in treasury)	$ 74,178	$ 6,330
Purchase of 407 shares of preferred stock	—	16
Issuance of 3,225 common shares for exercised stock options	(22)	(59)
Retirement of 343,732 common shares and 842 preferred shares held in treasury	(4,527)	(6,287)
Balance April 1, 1978	69,629	—
Purchase of 3,155 shares of preferred stock		92
Retirement of 3,155 preferred shares held in treasury	65	(92)
Balance March 31, 1979	$ 69,694	$ —

NOTE 6 - DEBT:

Debt consists of the following:

	March 31, 1979	April 1, 1978
	(in thousands)	
8.4% Promissory Notes	$ 65,000	$ 65,000
8% Sinking Fund Debentures less unamortized discount of $1,020,000 resulting in an effective rate of 10%	13,980	—
Notes payable to parent	15,000	—
Notes payable to banks due through April 30, 1979, interest at 10½% to 11-1/8%	15,000	—
Mortgages expected to be repaid within one year, interest at 7¾% to 8%	10,693	—
	119,673	65,000
Less - amount due within one year	30,693	—
Long-term debt	$ 88,980	$ 65,000

On May 18, 1979, the 8.4% Promissory Notes were refinanced pursuant to a new 8.95% Promissory Note Agreement amounting to $95,000,000. The 8.95% Note requires annual repayment of principal of $5,000,000 from 1984 to 1985, $6,150,000 from 1986 to 1998 and $5,050,000 in 1999.

As discussed in Note 1, the Company assumed Colonial's 8% Sinking Fund Debentures due 1996 which require annual sinking fund payments of $800,000 beginning in 1982 and $3,800,000 in 1996.

The above agreements contain various restrictions on the Company including provisions with respect to long-term debt and the payment of dividends. At March 31, 1979, after giving effect to the new 8.95% Promissory Note Agreement, approx-

imately $30,000,000 of the Company's retained earnings would have been free of restrictions.

On August 29, 1978, the Company borrowed $15,000,000 from Cavenham (USA) Inc., with provisions for interest based on prevailing rates which averaged 11.9%. The notes provide for repayment of $5,000,000 on demand and $10,000,000 in January 1982.

NOTE 7 - COMPENSATING BALANCES AND BORROWING ARRANGEMENTS:

The Company has unused borrowing arrangements with a number of banks aggregating $25,900,000. To the extent that compensating balances are maintained, a substantial portion of such balances would normally be covered by incompleted transactions with banks.

NOTE 8 - PROPERTY LEASES:

As stated in Note 2, the accompanying financial statements have been restated in accordance with the requirements of FAS 13. The effect of this change was not material to the results of operations in any period and resulted in a cumulative reduction of retained earnings of $2,675,000 at April 2, 1977.

The Company operates principally in leased stores, distribution facilities and offices and, in most cases, holds renewal options with varying terms. Many of the leases contain escalation clauses which provide for increased rentals based upon increases in real estate taxes and lessors' operating expenses.

The following is a schedule by years of future minimum payments under capital leases together with the present value of the net minimum lease payments as of March 31, 1979.

	Amount (in thousands)
1980	$ 11,123
1981	10,863
1982	10,569
1983	17,451
1984	18,309
Later years	78,735
Total minimum lease payments	147,050
Less: amount representing estimated executory costs included in total minimum lease payments	16,421
Net minimum lease payments	130,629
Less: amount representing interest	60,215
Present value of net minimum lease payments	70,414
Less, current portion of obligations under capital leases	3,762
Long-term capital lease obligations	$ 66,652

The minimum lease payments shown above do not include future minimum sublease rentals of $5,300,000 under noncancelable subleases or contingent rentals which may be paid under certain store leases on the basis of percentages of sales in excess of stipulated amounts.

The following is a schedule by years of future minimum rental payments required, less minimum sublease rental income, under operating leases that have initial lease terms in excess of one year as of March 31, 1979.

	Amount (in thousands)
1980	$ 31,563
1981	29,403
1982	27,347
1983	25,019
1984	22,277
Later years	161,376
Total minimum payments	296,985
Less: sublease rental income	7,306
Net minimum rentals	$ 289,679

The following schedule shows the composition of total rental expense for all operating leases:

	52 weeks ended	
	March 31, 1979	April 1, 1978
	(in thousands)	
Minimum rentals	$ 28,369	$ 25,854
Contingent rentals	3,762	1,538
Less: sublease rentals	(3,062)	(2,253)
	$ 29,069	$ 25,139

NOTE 9 - PENSION PLANS:

Pension expense under the Company's pension plans described in Note 2 was $4,768,000 and $2,640,000 for the 52 weeks ended March 31, 1979 and April 1, 1978, respectively. As a result of the acquisition of Colonial an amount aggregating $21,750,000 has been recorded to recognize unfunded vested benefits as of the dates of acquisition.

NOTE 10 - CONTINGENCIES:

The Company has been named as a co-defendant in numerous similar antitrust actions brought by producers and feeders of cattle. Each of the actions allege violations by the defendants of the federal antitrust laws in connection with the purchase and sale of beef and seeks damages and injunctive relief. Certain of these lawsuits have been dismissed and are presently on appeal. The remaining lawsuits are in early pre-trial stage. It is not possible to predict with any degree of certainty the ultimate outcome of any of these lawsuits since, among other things, the conduct of the other defendants as alleged co-conspirators could affect the liability of the Company. The management of the Company believes that the Company has good and meritorious defenses to each of such lawsuits.

A purported class and derivative action has been brought against the Company and its parents seeking the rescission of the merger in which Cavenham (USA) Inc. acquired the remaining 19% minority interest in the Company's common stock and the recovery of unspecified damages, costs and

attorneys' fees. The Company and its parents believe that its actions have been entirely proper and lawful and intend to defend the lawsuit vigorously.

In connection with the Company's acquisition of Colonial Stores Incorporated, The Federal Trade Commission has initiated a proceeding against the Company, Cavenham (USA), Cavenham Holdings and Colonial. The Commission contends that the acquisition violates the antimerger provisions of the federal antitrust laws and has advised the Company that it may order relief, including, but not limited to, divestiture of Colonial and prohibition of further acquisitions of a retail food business for 10 years without the Commission's prior approval. The management of the Company believes it has good and meritorious defenses to the Commission's claims.

NOTE 11- ASSET REPLACEMENT COST (UNAUDITED):

The Company's annual report on Form 10-K contains estimated additional costs which would be required if the Company were to replace its inventory and productive capacity at March 31, 1979 and April 1, 1978, and the related estimated effect of such costs on depreciation expense and cost of sales.

Replacement cost of inventories and cost of sales closely approximated the amounts reported on the consolidated balance sheet and income statement due to the relatively short time lag between incurring inventory costs and their subsequent conversion into sales revenue.

Although the cumulative impact of inflation over a number of years has resulted in a substantially greater capital investment to replace productive capacity compared to historical cost, such greater replacement costs were partially offset by technological improvements and design changes which often resulted in increased productivity and a maintenance of the Company's profit margin.

Regulations promulgated by the Securities and Exchange Commission governing replacement costs do not specify uniform procedures for development of replacement costs. In addition, the above information necessarily reflects the subjective judgment of management and estimations based on available information.

Report of Independent Accountants

Price Waterhouse & Co.

Hackensack, New Jersey
May 1, 1979, except as to Note 6,
which is as of May 18, 1979

To The Board of Directors and Stockholders of The Grand Union Company:

We have examined the consolidated balance sheets of The Grand Union Company and its subsidiaries as of March 31, 1979 and April 1, 1978, and the related consolidated statements of income and retained earnings and of changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements examined by us present fairly the financial position of The Grand Union Company and its subsidiaries at March 31, 1979 and April 1, 1978, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis after restatement for the change, with which we concur, in the method of accounting for leases as described in Notes 2 and 8 to the consolidated financial statements.

Price Waterhouse & Co.

Management Discussion and Analysis of the Consolidated Statement of Income and Retained Earnings

Fiscal Year 1978 vs. Fiscal Year 1977

As discussed in Note 1 to the financial statements, the Company acquired all of the outstanding shares of Colonial Stores Incorporated. Accordingly, the increases in the reported levels of revenues, expenses and net income for the current year are primarily caused by the increase in the number of stores resulting from the acquisition.

The increase in interest expense reflects the higher level of indebtedness during the current year. The decrease in interest income reflects the reduction in temporary cash investments resulting from the acquisition of Colonial.

The effective tax rate for 1978 was 37% as compared to 34% for 1977. The increase primarily resulted from the benefit of non-recurring capital loss carryforwards in the prior year and a relatively lower benefit of the Company's share of tax savings as a participant in the Holdings tax sharing agreement.

Fiscal Year 1977 vs. Fiscal Year 1976

Net income declined as compared to the preceding year reflecting the effects of higher operating, administrative and general expenses, specifically labor and utility costs, and by the increased competition in most of the chain's areas of operation.

Sales for fiscal 1977 increased only slightly over fiscal 1976, although gross profit as a percent of sales remained level with the preceding year.

The increase in interest expense reflects the higher level of indebtedness during the current year. The increase in interest income is due to the higher level of temporary cash investments and interest rates during the current year.

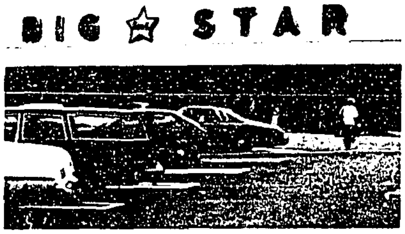
The effective tax rate for 1977 was 34% as compared to 42% for 1976. The decrease resulted from a non-recurring tax benefit arising from utilization of capital loss carryforwards and the relatively higher benefit of the Company's share of tax savings as a participant in the Holdings tax sharing agreement.

Five-Year Financial Summary (a)

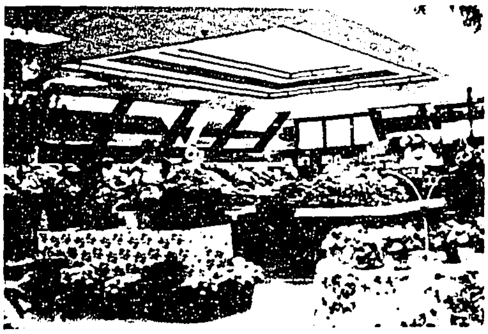
The Grand Union Company and Subsidiaries
(Amounts in thousands)

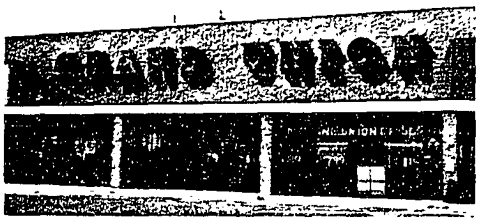
For the Fiscal Year Ended	March 31, 1979 (b)	April 1, 1978	April 2, 1977	April 3, 1976 (c)	March 1, 1975
Sales	$2,398,944	$1,649,274	$1,622,633	$1,611,195	$1,562,736
Cost of sales	1,861,470	1,283,853	1,266,057	1,274,485	1,228,744
Gross profit	537,474	365,421	356,576	336,710	333,992
Operating, administrative and general expenses	(494,146)	(340,410)	(323,235)	(304,255)	(305,536)
Provision for store closings	—	—	—	(8,150)	(2,093)
Write-down of preferred stocks	—	—	—	—	(4,619)
Interest expense	(13,139)	(8,369)	(5,939)	(6,241)	(7,343)
Interest income, principally on temporary cash investments	4,815	5,361	2,453	2,651	3,597
Income before income taxes	35,004	22,003	29,855	20,715	17,998
Provision for income taxes	(13,000)	(7,384)	(12,436)	(9,247)	(8,651)
Income before minority interest	22,004	14,619	17,419	11,468	9,347
Minority interest in earnings of subsidiary	(141)	—	—	—	—
Net income	$ 21,863	$ 14,619	$ 17,419	$ 11,468	$ 9,347
Net income as a percent of sales	.91%	.89%	1.07%	.71%	.60%
At the Year End					
Ratio of current assets to current liabilities	1.47 to 1	2.09 to 1	2.01 to 1	1.97 to 1	2.05 to 1
Number of stores at year end:					
Supermarkets	840	479	484	487	503
Grand Way stores	14	14	14	14	14
Grand Catalog Showrooms	8	9	9	9	17

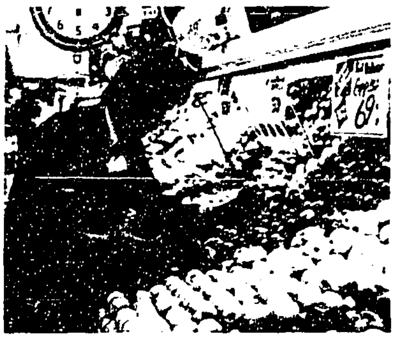
(a) Amounts reflect restatement for retroactive adoption of FAS 13. (See notes 2 and 8.)
(b) Includes results of Colonial Stores Incorporated from dates of acquisition. (See note 1.)
(c) 53-week fiscal year.



Attractive supermarkets, friendly employees, specialized departments and a wide range of merchandise are the hallmarks of Grand Union and Big Star supermarkets through a 15-State trading area along the Eastern seaboard.







GRAND UNION

Directors

James Wood
Chairman of the Board and
Chief Executive Officer,
The Grand Union Company;
Managing Director, Retailing Division
Cavenham Limited

Emerson E. Brightman

Patrick A. Deo
President and Chief Operating Officer,
The Grand Union Company

Thomas R. Doyle
Executive Vice President and
Assistant to the Chairman,
The Grand Union Company

Sir James Goldsmith
President-Directeur General,
Generale Occidentale, S.A.;
Chairman, Cavenham Limited

Alan C. Goulding.
Executive Vice President and
President of Colonial Stores Division,
The Grand Union Company

Bowman Gray III
Vice President,
Cavenham (USA) Inc.

Jack Greenhalgh
Deputy Chairman,
Cavenham Limited

Michael L. Haynes
Director, Cavenham Limited

Dr. Rafael Picó
Vice Chairman (Retired)
Banco Popular de Puerto Rico

Arthur Ross
Vice Chairman and Managing Director,
Central National Corporation

Lionel J. Ross
Financial Director,
Cavenham Limited

Earl R. Silvers, Jr.
Vice President and Secretary,
The Grand Union Company

Stuart S. Tarrant
Executive Vice President,
The Grand Union Company

Officers

James Wood
Chairman of the Board and
Chief Executive Officer

Thomas R. Doyle
Executive Vice President and
Assistant to the Chairman

Patrick A. Deo
President and
Chief Operating Officer

Alan C. Goulding
Executive Vice President and
President of
Colonial Stores Division

Stuart S. Tarrant
Executive Vice President

Ernest H. Berthold
Senior Vice President

James W. Rowe
Senior Vice President

Caryle J. Sherwin
Senior Vice President

Louis Sherwood
Senior Vice President

Vincent J. Veninata
Senior Vice President

James M. Hayes
Vice President

Bertram S. Kaiser
Vice President

J. Barron Leeds
Vice President

Joseph J. McCaig
Vice President

Rodney L. Renne'
Vice President

William K. Rotert
Vice President

Russell W. Schroeder
Vice President

Earl R. Silvers, Jr.
Vice President and Secretary

William G. Spearman
Vice President

William F. Stewart
Vice President

Vito A. Cardace
Controller

Roger W. Kennedy
Treasurer

Baxter T. Duffy
Assistant Secretary

Frederick H. Guntsch
Assistant Secretary

THE GRAND UNION COMPANY
100 Broadway, Elmwood Park, New Jersey 07407